



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

MAR 28 2002

THE INSPECTOR GENERAL

ED-OIG/A06-A0020

Mr. Greg Woods
Chief Operating Officer
Federal Student Aid
U.S. Department of Education
Union Center Plaza, Room 112G1
830 First Street, NE
Washington, DC 20202

Dear Mr. Woods:

This **Final Audit Report** (Control Number ED-OIG/A06-A0020) presents the results of our audit of the Effectiveness of the Department's Student Financial Aid Application Verification Process. The objective of our audit was to determine if the Department had adequate controls to ensure that appropriate "targeted selection criteria" are used, the effectiveness of the verification process is evaluated, and schools complete verification requirements.

A draft of this Office of Inspector General report was provided to Federal Student Aid (FSA).¹ In response to the draft report, FSA agreed with three of our four recommendations. Regarding our recommendation that FSA establish controls that provide for monitoring the overall effectiveness of the verification process, FSA stated that it had such controls and described ongoing activities, analyses, and improvements related to verification. We agree that FSA's actions should improve verification. We modified our recommendations based on these representations. We note that not all of the actions have been implemented and FSA will need to monitor the overall effectiveness of the actions on the verification process. We have summarized FSA's comments after the recommendations. A copy of the complete response is enclosed with this report.

BACKGROUND

Title IV of the Higher Education Act of 1965, as amended, provides federal financial aid in the form of grants, loans, and work study for eligible applicants based on key financial and other information the applicants provide on the Free Application for Federal Student Aid. Applications are submitted to the Department's Central Processing System (CPS). The CPS operates under a contract with the Department to provide electronic processing of applications.

¹ Student Financial Assistance changed its name to FSA effective March 6, 2002. All references to Student Financial Assistance have been changed to FSA in this final report.

The CPS uses the application information and the statutory needs analysis formula to calculate each applicant's expected family contribution (EFC). If the EFC is less than the student's cost of attendance, an eligible student is considered to have financial need and a school can award the student Title IV aid. Verification is a process used to ensure students and parents report accurate financial and demographic data for use in determining their Title IV eligibility.

The Department's objective for the verification process is to identify applicants for verification who have the highest likelihood of errors in their applications so that schools can correct the erroneous data. The Department, assisted by CPS staff, develops new "targeted selection criteria" annually to accomplish this objective. CPS staff tested the proposed new "targeted selection criteria" by applying the criteria to samples of actual applicant data from prior years. This process resulted in the 37 different "targeted selection criteria" that the CPS used to select applicants for verification during the 1999-00 award year.

Based on the predetermined "targeted selection criteria," the CPS uses applicant information to select certain applications for verification. For the selected applications, schools must verify the accuracy of five major data elements reported by students. These elements are adjusted gross income, income tax paid, household size, number enrolled in college, and certain untaxed income/benefits. Applicants must provide schools with income tax returns and other documents to support these data elements. Schools and applicants must complete verification by established deadlines or the applicants forfeit their Federal Pell Grant for the award year, may not receive any other Title IV disbursements, and must repay to the school any Federal Supplemental Educational Opportunity Grant (FSEOG) or Federal Perkins Loan disbursements received. The school must return to the lender or the Secretary, in the case of William D. Ford Federal Direct Loans (Direct Loans), any Federal Stafford Loan or subsidized Direct Loan proceeds that would otherwise be payable to the applicants and return to the appropriate program account any Pell Grant, FSEOG, or Federal Perkins Loan disbursements not repaid by the student.

The school has completed verification when it has corrected the data or determined that the application data are correct. The school must document the verification and have on file the final and valid output document showing the student's official EFC. A final and valid output document is one that contains an EFC based on correct application data. The document can be either a Student Aid Report, which is a paper output document that is sent to the applicant, or an Institutional Student Information Record, which is an electronic record that is sent to the school. The school must have one of these documents in order to disburse need-based Title IV aid to a student.

When a school disburses a Pell Grant, it must report to the Department's Recipient and Financial Management System (RFMS) the disbursement amount and a code that identifies either verification was performed and the results of that verification or verification was not performed. Schools use verification status codes to report verification results. Proper reporting of these codes shows that the verification procedures have been followed and can allow the Department to gather information on the effectiveness of the verification requirements. Verification results do not have to be reported for loan only students.

The Department has instructed schools to use the following seven verification status codes in their reporting to the RFMS:

- **A**–Accurate. Verification was completed and the most recent record is accurate.
- **T**–Tolerance. Verification was completed and some data items were found to be incorrect. The discrepancy was within tolerance, and the student was paid based on uncorrected data.
- **C**–Calculated. Verification was completed and the record was found to be incorrect. The school recalculated the EFC and determined that the recalculated award would be the same or higher than the original award. The school paid based on the original EFC without requiring the record be corrected and reprocessed.
- **R**–Reprocessed. Verification was completed and the record was found to be incorrect. The record was corrected and reprocessed, and the school paid based on the reprocessed data.
- **W**–Without Documentation. Verification required but not completed. A first disbursement was made. If verification is not completed and the student’s record still shows a *W* code after the deadline, the student’s award eligibility will be dropped from the Pell Grant payment system. The school will not receive additional Pell Grant funds for the student and must repay any funds already disbursed.
- **S**–Selected, Not Verified. Applicant was selected for verification but not verified.
- **N**–Not Selected. Applicant was not selected and verification not done.

Verification is a labor-intensive process for the approximately 5,500 schools certified to participate in the Title IV programs. In award year 1999-00, schools reported verifying application data for over 1.5 million of the 3.9 million Pell Grant recipients. Based on our reviews at six schools, we estimate that schools nationwide spent about \$124 million in annual salary and other costs to complete the verification process during award year 1999-2000.

Federal Student Aid is the principal office within the Department responsible for the Title IV application verification process. The effectiveness of the verification process is not a performance indicator in the FSA fiscal year 2001 performance plan.

AUDIT RESULTS

Although the Department’s controls for developing “targeted selection criteria” were generally adequate, the Department has not established adequate controls for monitoring the effectiveness of the verification process or for ensuring schools complete the verification requirements. Schools nationwide spend an estimated \$124 million in annual salary and other costs to complete verification. The Department collects data on the results of the schools’ verification, but it does not use that data for monitoring the effectiveness of the verification or the extent to which

schools comply with the verification requirements. The Department also has not established controls to ensure that the data are reliable.

Management Controls Require Monitoring

Office of Management and Budget Circular A-123 (A-123) requires Federal agencies and managers to develop and implement appropriate management controls to ensure that (1) reliable and timely information is obtained, maintained, reported and used for decision making and (2) Federal programs achieve their intended results. A-123 states, “good management controls can assure that performance measures are complete and accurate.” A-123 further states that the controls “should support the effectiveness and the integrity of every step of the process and provide continual feedback to management.”

According to Standards for Internal Control in the Federal Government, issued by the General Accounting Office in November 1999, management controls should “be designed to assure that ongoing monitoring occurs in the course of normal operations It includes regular management and supervisory activities, comparisons, reconciliations, and other actions”

Data Collected for Monitoring Not Used and Unreliable

The Department needs to establish better controls for monitoring verification in order to meet the requirements of A-123 and the internal control standards identified by the General Accounting Office. Although the Department collected information on the results of verification from the CPS and RFMS, it did not use that information to monitor the overall effectiveness of the verification process or to develop new “targeted selection criteria.” The Department also has not taken steps to ensure that the data were reliable.

The Department requires the CPS to analyze verification results and to provide three management information system (MIS) reports from that analysis. The reports show for each of the 37 “targeted selection criteria,” the number of applicants who met each criteria, number who were selected for verification under each criteria, and the average overall change in the applicants’ EFC after verification. The Department’s goal is to select approximately 30 percent of total applicants for verification. Department officials told us that they used the MIS reports only to determine if the approximately 30 percent of total applicants were being selected.

The RFMS maintains information on verification results that the Department requires schools to report for each Pell Grant recipient. The Department’s stated purposes for requiring schools to report verification status codes to the RFMS are to allow the Department to gather information on the effectiveness of the verification requirements and to show that schools were following verification procedures. Department officials also told us that the verification data reported by schools to the RFMS were used only to monitor schools that reported the required verification of an applicant was not completed (i.e., a status code *W*). The Department used this data to reduce schools’ funding levels by the amount of Pell Grants awarded to applicants for whom the schools reported verification was not completed.

We determined that neither the MIS reports produced by the CPS nor the RFMS contained reliable data on the results of verification. The Department needs to improve the reliability of

the data from these sources so that the information can be used to monitor the effectiveness of the verification process and identify schools for program reviews or other monitoring activities.

MIS Reports

Our review of MIS report data and discussions with CPS officials confirmed that the MIS reports contained unreliable data. For example, one MIS report showed that while 18,139 applicants met one of the 37 “targeted selection criteria,” more than twice that many applicants were selected for verification, and more than three times that many applicants submitted corrections. For another criterion, the report showed 177,020 applicants met the criterion, 326 applicants were selected, and 10,911 of the selected applicants submitted corrections. In this example, the report showed over 10,000 more applicants submitted corrections than had been selected for verification. We concluded such data were not reliable. Since these numbers were used to calculate the average changes to the EFC as a result of verification, we also concluded those averages are incorrect. For Pell Grant eligible applicants, the MIS report showed that on average each applicant selected for verification became eligible for an additional \$2,068 in grants during award year 1999-00.

Department officials could not explain how the data in the MIS reports were compiled and referred us to a CPS official. The CPS official provided several examples to demonstrate the process used to compile the data. One example showed that a change submitted as a result of verification caused a reduction in the count total and an increase in the EFC for a criterion even though the applicant had not been selected for verification under that criterion. Based on our analysis of the examples, we concluded that the data in the MIS reports could not be used for monitoring either the number selected for verification or the effectiveness of the verification process.

RFMS Data

The RFMS also contained unreliable data on verification results. For example, our analysis of RFMS data for award year 1999-00 identified over 1,300 schools that reported finding no errors as a result of verifying all the applications of Pell Grant recipients who were selected for verification during that year. This data should have raised questions about either the school’s verification procedures, the accuracy of the school’s reporting, or the effectiveness of the verification selection criteria in identifying error-prone applications.

We judgmentally selected six schools from the RFMS data to visit and found that these schools reported inaccurate verification results and did not always complete the required verification. In total, we randomly selected for review 313 Pell Grant recipients who were selected for verification at the six schools. We determined that the six schools reported inaccurate verification results for 198 (63 percent) of our sampled recipients and did not complete the required verification for 70 (22 percent) of the sampled recipients. The appendix to this report contains additional details of our findings at the six schools.

We determined that inadequate controls in the Department’s EDEExpress software contributed to one school’s inaccurate reporting and disbursement of \$14,072 of unallowable Title IV funds. CPS staff developed EDEExpress to assist schools in processing financial aid and transmitting to

the RFMS data on awards, disbursements, and verification results. The EDEExpress software allows schools to enter the verification status codes on one of two different screens. The software incorporated a control for one screen that defaulted the verification status code to *W* if the school failed to enter a code for a recipient, but the second screen did not default to a *W*. As a result, the school was able to obtain Pell Grants and other Title IV aid even though the school had not completed the required verification for 12 (24 percent) of 50 sampled recipients.

RECOMMENDATIONS

We recommend that the Chief Operating Officer for FSA:

1. Strengthen FSA's controls to ensure that data in MIS reports and the RFMS are reliable and can be used to monitor the effectiveness of the verification process.
2. Identify and evaluate the controls it has established to ensure that they are useful in monitoring the overall effectiveness of the verification process.
3. Conduct an analysis of the verification data that schools are required to report to the RFMS. Based on the results of that analysis, perform reviews at or provide technical assistance to schools that report questionable verification results or that are not performing the required number of verifications.
4. Modify EDEExpress software to prevent schools from receiving Pell Grant funds without reporting the correct verification results.

FSA'S COMMENTS TO THE DRAFT REPORT AND OIG'S RESPONSE

We did not change our conclusions based on FSA's response. FSA generally concurred with recommendation numbers one, three, and four. The response noted that for the 2002-03 processing cycle, FSA eliminated the old MIS reports and will begin producing a new report to monitor the verification process. The response also noted that beginning in 2002-03, FSA simplified the way schools report verification results to the RFMS, which should improve the reliability of the data.

Regarding recommendation number two, FSA said that it had controls in place to monitor and evaluate the overall effectiveness of the verification process using CPS and RFMS data. We modified our recommendation number two based on these representations. We note that the response did not discuss what those controls were nor did the response address how the controls would ensure that the effectiveness of the verification process is monitored. The response discussed FSA's "other ongoing activities, analyses, and improvements related to

verification” Most of the actions discussed in the response were not implemented until after our audit period and we have not evaluated them. The other ongoing actions discussed in the response are listed below followed by our response.

FSA’s Comments. The annual analysis that compares individuals selected for verification with a control group that is not verified showed that verification prevented more than \$108 million in award errors during the 2000-01 school year.

OIG’s Response. While the annual analysis was useful in developing new “targeted selection criteria,” it was not used by FSA to monitor the overall effectiveness of the current year’s verification process. The analysis included randomly selecting and comparing changes to applicants’ data for two control groups of applicants in each of the three prior years. All applicants in the first control group were immune from verification (i.e., not selected) and all applicants in the second control group were selected for verification. Applicants in the second control group were selected randomly and not on the basis of any “targeted selection criteria.” We agree that verifying applicant records does prevent award errors, however, any award errors prevented as a result of verifying applicants in the control group could not be attributed to the effectiveness of the current year’s “targeted selection criteria.”

FSA’s Comments. Beginning with the 2001-02 year, FSA is able to compare applicant data from the CPS to recipient data in the RFMS. Reports will be prepared identifying schools with large percentages of recipients with incomplete verification statuses (i.e., W codes) and other unusual activity.

OIG’s Response. We agree that the new reports should improve FSA’s monitoring of verification. No such reports were prepared during our audit. FSA can still monitor school verification without the new reports. Since schools report verification status codes only to the RFMS, CPS data is not necessary to identify schools with large percentages of incomplete verification status or other unusual activity. The data necessary to determine this is available in the RFMS.

FSA’s Comments. FSA will be proactively reminding all schools that have made disbursements to students selected for verification to complete verification by using the Common Origination and Disbursement (COD) system beginning in 2002-03.

OIG’s Response. We agree that FSA’s action should improve verification. The COD had not been implemented at the time of our audit.

FSA’s Comments. FSA monitors the effectiveness of verification through the Quality Assurance (QA) Program.

OIG’s Response. The QA Program may provide FSA with useful information for improving the verification process. QA schools are exempt from the regulatory verification requirements so that they may develop school-specific processes that

improve the accuracy of their student reported data. The effectiveness of the school-specific processes used by the 111 QA schools does not provide information on the overall effectiveness of the verification process required to be used by the approximately 5,400 other schools certified to participate in the Title IV programs.

FSA's Comments. The response noted that legal obstacles prevented the systematic matching of applicant data with IRS tax return data. FSA explained that given these circumstances, interim measures were identified that could immediately save millions in award errors. These measures included using information learned from an IRS study, the QA schools, and other efforts to "more precisely identify the factors that yield the greatest benefit in reducing payment errors." The response went on to discuss several other measures that were planned or underway, including selecting only Pell-eligible applicants for verification, encouraging schools to verify all selected applicants, a pilot project with the IRS using the Internet to electronically enable students and their families to request that the IRS send a copy of their tax return directly to the school, and continued support for legislative changes that would allow FSA to perform an electronic match with the IRS.

OIG's Response. Errors in applications of applicants seeking only loans (e.g., graduate students) may not be detected if only Pell-eligible applicants are selected for verification. We agree that the other measures should improve the process.

OTHER MATTERS

Verification Process is Labor Intensive and Costly for Schools

Schools spend staffing resources annually to perform required verifications and report the results to the Department. The six schools we visited spent an estimated \$481,700 in salary and other costs during award year 1999-00 to verify applications for 5,922 Pell Grant recipients. Based on our analysis at the six schools, we estimate that schools nationwide spent almost \$124 million in annual salary and other costs to complete the verification process.²

The cost and labor burden on schools and students to comply with the verification requirements would be significantly reduced if the Department was able to implement a match of applicant reported income data with the income data that applicants and their parents reported on their income tax returns to the IRS. The Higher Education Act Amendments of 1998 authorized the Secretary of Education to confirm directly with the IRS the adjusted gross income, taxes paid, filing status, and number of exemptions claimed, as reported by students and parents on their financial aid applications.

²The \$124 million estimate is based on the average cost per application verified at the six schools multiplied by the total number of Pell Grant recipients whose applications were verified by schools nationwide during award year 1999-00 (i.e., \$81.34 times 1,523,769 recipients).

A database match with the IRS would eliminate the need for schools to spend staffing and other resources to collect paper copies of tax returns submitted by students (and parents if the student is dependent) to verify income data. It could also result in more accurate Title IV awards to students because schools would not have to rely on the paper tax returns and could identify income-reporting errors that the current verification process has not identified.

The Department should continue to pursue with the IRS, Office of Management and Budget, and Congress, if necessary, implementing the IRS match in its application processing. The Department should be able to perform the verification of taxable income for all applicants (rather than just selected applicants) and schools would not have to rely on students and parents to provide valid tax returns. Schools would still have to verify the number in college and untaxed income and benefits.

In response to our draft report, FSA said it agreed having an IRS income match would be beneficial and that it was working toward that goal. FSA mentioned the legal hurdles that must be overcome and that it was “awaiting the outcome of our efforts with Treasury and Congress.”

OBJECTIVE, SCOPE AND METHODOLOGY

The objective of our audit was to determine whether the Department has adequate controls to ensure that appropriate verification selection criteria are used, the effectiveness of the verification process is evaluated, and schools complete verification requirements.

To accomplish our objective, we interviewed Department, CPS, and Macro International (a CPS subcontractor) officials. We reviewed documentation of the subcontractor’s testing of the 2000-01 “targeted selection criteria,” MIS reports relating to the effectiveness of the verification process, and the July 2000 final report on the first IRS income match study. We also reviewed the Department’s records relating to program reviews and Independent Public Accountant’s compliance audits that had verification findings in award years 1998-99 and 1999-00, the Department’s 1998-2002 Strategic Plan, FSA’s Fiscal Year 2001 Performance Plan, and the 2000 Federal Managers’ Financial Integrity Act Report.

Based on our analysis of award year 1999-00 RFMS data, we judgmentally selected six schools for review: four public schools located in San Marcos and Waco, Texas, Los Angeles, California, and Little Rock, Arkansas; one private nonprofit school located in Salisbury, North Carolina; and one proprietary school located in Santa Ana, California. These schools were selected based primarily on their reporting a high percentage of one verification status code for the schools’ Pell Grant recipients with some consideration given to the type and location of the schools. The appendix provides additional details on the six schools and our basis for selecting them.

We visited each of the six schools and obtained background information about the schools, interviewed school officials, and reviewed the schools’ policies and procedures relating to verification. At each school, we randomly selected for review 50 (63 at one school) Pell Grant recipients from the universe of recipients who were selected for verification in award year 1999-00. In total, we selected for review 313 recipients at the six schools from a universe of 5,922

recipients. We reviewed the schools' financial aid files for 311 of the 313 recipients (one school was unable to provide the files for two recipients). We also obtained the total salary and other costs that the six schools estimated they incurred to complete verification during award year 1999-00. We calculated an average cost per application verified for the six schools and multiplied the average cost (\$81.34) by the total number of Pell Grant recipients whose applications were verified at all schools (1,523,769) during award year 1999-00. This process resulted in an estimated nationwide cost to schools to complete verification of about \$124 million for the award year.

We relied on computer-processed data contained in the RFMS to select the six schools and to obtain random samples of Pell Grant recipients for review. We did not rely on computer-processed data to accomplish our file reviews at the six schools. We performed limited tests of the RFMS data at the six schools to verify its reliability. Based on the results of the tests described, we concluded that, while the computerized data on disbursements were reliable for the purposes of our audit, the data related to verification status codes were not reliable because schools reported incorrect data to the RFMS. We reported this in the AUDIT RESULTS section of this report.

We conducted our fieldwork at the Department in Washington, DC, in August 2000 and March 2001. Our exit conference was held on August 21, 2001. We conducted fieldwork at the six schools from November 27, 2000, through April 12, 2001. Our audit was performed in accordance with government auditing standards appropriate to the scope of the audit described.

STATEMENT ON MANAGEMENT CONTROLS

As part of our review, we assessed the system of management controls, policies, procedures, and practices applicable to the Title IV application verification process. Our assessment was performed to determine the level of control risk for determining the nature, extent, and timing of our substantive tests to accomplish the audit objective.

For purposes of this report, we assessed and classified the significant controls into the following categories: (1) development of targeted verification selection criteria; (2) monitoring the effectiveness of verification; and (3) school compliance with the verification process.

Because of inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the management controls. However, our assessment disclosed management control weaknesses that adversely affected the Department's ability to comply with the regulations. These weaknesses included inadequate

procedures to monitor the effectiveness of the verification process and to ensure accuracy of verification results reported by the schools. These weaknesses are discussed in the AUDIT RESULTS section of this report.

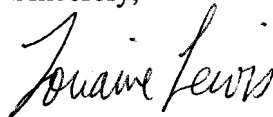
ADMINISTRATIVE MATTERS

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

If you have any questions or if you wish to discuss the contents of this report, please contact Sherri L. Demmel, Regional Inspector General for Audit, Dallas, Texas, at 214-880-3031. Please refer to the control number in all correspondence related to the report.

Sincerely,

A handwritten signature in cursive script that reads "Lorraine Lewis".

Lorraine Lewis

Enclosure

Enclosure
Audit Results at Six Schools Visited
July 1, 1999, through June 30, 2000

(1) School Type	(2) State	(3) Pell Grants (millions)	(4) High % of Status Code	(5) Total Recipients	(6) Total Selected for Ver.	(7) OIG Sample	(8) Ver. Not Done or Incomplete	(9) Inaccurate Reporting
1) 4 yr. Public	TX	\$7.3	R	3,917	2,156	50	8	5
2) 2 yr. Public	TX	3.3	A	1,906	813	50	2	32
3) 4 yr. Non- profit	NC	1.8	S	765	333	63	45	63
4) 2 yr. Public	CA	7.2	S	3,375	624	50	12	50
5) Pri- vate	CA	7.1	T	3,775	624	50	2	31
6) 4 yr. Public	AR	5.4	W	2,907	1,372	50	1	17
Total				16,645	5,922 (36%)	313	70 (22%)	198 (63%)

Note: The above totals and percentages relate only to the six schools we visited and may not be representative of the universe of schools that participated in the Title IV programs. We selected the schools primarily because they reported a high percent of one type of verification status code (column 4 above). For example, school number one reported a code *R* (verification completed, record corrected and reprocessed) for 89 percent of the total recipients who were selected for verification. School number two reported a code *A* (verification completed, record was accurate) for 100 percent of its total selected recipients.

Legend for Verification Status Codes in Column 4:

A—Accurate. Verification was completed and the most recent record is accurate.

R—Reprocessed. Verification was completed and the record was found to be incorrect. The record was corrected and reprocessed.

S—Selected, Not Verified. Applicant was selected for verification but not verified.

T—Tolerance. Verification was completed and some data items were found to be incorrect. The discrepancy was within tolerance.

W—Without Documentation. Verification required but not completed.



UNITED STATES DEPARTMENT OF EDUCATION

*Student Financial Assistance
Chief Operating Officer*

JAN - 4 2002

Ms. Sherri Demmel, Regional Inspector General for Audit
Office of Inspector General
U.S. Department of Education
1999 Bryan Street, Harwood Center, Suite 2630
Dallas, TX 75201-6817

Dear Ms. Demmel:

Thank you for the opportunity to review and comment on the draft audit report entitled, *Review of the Effectiveness of the Title IV Student Financial Aid Application Verification Process*, Control Number ED-OIG/A06-A0020, issued December 5, 2001.

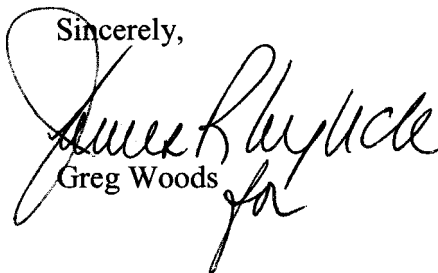
We are pleased that you found that Student Financial Assistance's controls for developing verification selection criteria are satisfactory. As with other oversight activities that we perform, we try to balance our mandate to ensure program integrity with the need to mitigate institutional burden. We are glad that our selection criteria are focusing our verification efforts properly.

In general, we agree with some of your recommendations and we have already begun the process of making changes to improve our overall verification process. We are confident these changes will provide us with more accurate and reliable data to assist us in making decisions and in saving millions of dollars each year by preventing award errors.

Finally, the recommendation that we establish controls to monitor the effectiveness of verification using reliable data from some of our systems gives the impression that we have no such controls. However, we do have such controls in place and we do monitor the effectiveness of the verification process because accurate reporting by students is central to ensuring the effectiveness of the Title IV programs. In addition, we have made, and continue to make, improvements in this area and we consider the actions we have taken to close this issue.

The enclosure provides our response to each recommendation. Again, we appreciate the opportunity to review and comment on the draft report.

Sincerely,


Greg Woods

Enclosure

cc: Sherri Demmel
Pat Howard
Kay Jacks
Jennifer Douglas
Jim Lynch

Recommendation 1: Strengthen SFA's controls to ensure that data in MIS reports and the RFMS are reliable and can be used to monitor the effectiveness of the verification process.

Response: In general, we agree with this recommendation. However, in addition to using data from the Recipient Financial Management System (RFMS) and MIS reports, the Department already monitors the effectiveness of verification through a variety of methods, as we will describe in our response to Recommendation #2.

With regard to MIS reports, based on the OIG findings, we have developed a new report for the 2002-03 processing cycle, and we will eliminate the old MIS reports. The new monthly report will go into effect beginning in January, 2002, and will be available in early February. The report, entitled "*EFC Changes by Verification Criteria*," provides information on the expected family contribution (EFC) changes made as a result of corrections processed for applicants selected for verification. The percent and average change for EFC increases and decreases is included, as well as the net and absolute change.

As for RFMS data, the system is accurately capturing what schools are reporting as verification codes. The issue, as the OIG found in its sample, is that the verification codes are often reported inaccurately. We believe this happens because schools misunderstand the code definitions. There are too many codes and their nuances are not easily explained. Therefore, beginning in 2002-03, verification codes will have only three values: "V" when the school has completed verification, "W" when the school makes an interim payment without completing verification, and blank when verification has not been performed. By simplifying the reporting, we believe verification data will be more reliable.

Recommendation 2: Establish controls that provide for monitoring the overall effectiveness of the verification process by using reliable verification results data that are available from the CPS and RFMS.

Response: We have controls in place to monitor and evaluate the overall effectiveness of the verification process using Central Processing System (CPS) and RFMS data. In addition, we have other ongoing activities, analyses, and improvements related to verification, which we will describe below.

We know that every year schools save millions of dollars in potential award errors by performing verification. We see the evidence of this as we update the selection criteria because part of our annual analysis compares individuals selected for verification with a control group that is not verified. We see significant differences between these groups. Based on program data, we estimate that the verification performed by schools prevented more than \$108 million in award errors (both overawards and underawards) during the 2000-01 school year.

Beginning with award year 2001-02, we are now able to compare applicant information from the CPS, to recipient information in RFMS, where the verification status code is reported. In addition to monitoring schools reporting that they paid students without waiting for supporting verification documentation (code “W”), we will be preparing reports of all verification codes reported to RFMS. Case Management teams will be informed not only of those schools where there are large percentages of “W” codes but also other unusual activity such as schools reporting all records as “A” (accurate), until the simplified codes we mentioned in our response to Recommendation #1 are in place.

We will also be proactively reminding all schools that have made disbursements to students selected for verification of the requirement to complete verification by using the Common Origination and Disbursement (COD) system beginning in 2002-03. Reports of verification activity will also continue.

But we do not just rely on CPS and RFMS data. We also monitor the effectiveness of verification through the Quality Assurance (QA) Program. For years, certain schools and the Department have worked hand-in-hand to develop school-specific processes that improve the accuracy of the data reported by their students. In exchange, these “Quality Assurance” schools are exempt from certain regulatory requirements. For the 1999-2000 school year, Quality Assurance schools boosted the effectiveness of verification by about 5 percent when they modified the verification process to better fit their individual campuses. About 111 schools saved taxpayers about \$1 million in Pell Grant overpayments.

In addition, we have already begun the process to strengthen the applicant verification selection criteria based on what we have learned from our QA schools and from the income match between the Department and the Internal Revenue Service (IRS). The Department’s test data match with the IRS shows that verifying income information with the IRS might have prevented approximately \$180 million in Pell Grant award errors for the 2000-01 school year. However, legal obstacles currently prevent the systematic matching of student aid applicant data with tax return data. Given the current circumstances, the Department has identified interim measures that could immediately save millions in award errors.

First, we are using the information learned from the IRS study, in combination with past verification experience in detecting errors and lessons learned from analyses performed by QA schools, to more precisely identify the factors that yield the greatest benefit in reducing payment errors. We will measure the effectiveness of the new criteria in reducing over- and under-awards for the 2002-03 school year.

Second, we are considering making three major changes to the way Pell Grant errors have historically been identified and corrected. These changes would:

- Focus verification efforts only on reported errors that affect the amount of aid received.
- Select only Pell-eligible students for verification. The current process limits selection to a total of 30 percent of all applicants in three categories: Dependent and Independent students, undergraduates and graduates, and Pell-eligible and ineligible students.

- Encourage schools to complete the verification process for every student selected by the Department, even if this means schools would be verifying more than 30 percent of their applicants. School compliance with this request would be voluntary because current statute and regulations prohibit the Department from requiring schools to verify more than 30 percent. Even without such encouragement, our records show that the majority of schools already verify every applicant identified by the Department and that about five percent of schools report verifying 100 percent of their students.

Third, as we stated in our response to Recommendation #1, we have developed a new MIS report for the 2002-03 processing cycle and we will eliminate the old reports.

Fourth, we are continuing to gain new information from the IRS, QA schools, and private industry.

- We currently have a pilot project with the IRS using the Internet to electronically enable students and their families to request that the IRS send a copy of their tax return directly to a school. This initiative helps streamline the verification process through the use of the Internet and it reduces the risk related to fraud because applicants cannot alter an IRS tax form sent directly from the Treasury to schools.
- We are continuing to conduct analyses with the IRS that will help us more fully understand the characteristics associated with errors in Pell payments. As we mentioned previously, one reason that this is an ongoing effort is the limitation we face in accessing IRS-reported data. Under current statutory provisions in the Internal Revenue Code, the IRS cannot provide us with individual taxpayer information. Instead, we are forced to analyze aggregated data from the IRS and then to apply our analyses to individuals applying for student aid. Although these analyses are limited, we have obtained useful, concrete information for management improvements from them, and we want to continue this effort.
- We want to target fraud, as well as unintentional award error. To improve our ability to identify potential fraud, we continue to support legislative changes allowing us to do electronic matches of application data with IRS Income Returns.

Recommendation 3: Conduct an analysis of the verification data that schools are required to report to the RFMS. Based on the results of that analysis, perform reviews at or provide technical assistance to schools that report questionable verification results or that are not performing the required number of verifications.

Response: We agree with this recommendation. For award year 2001-02, using RFMS to generate reports of all verification codes, we will identify those schools that report questionable verification codes or that are not performing the required number of verifications. Based on the results of further analysis of school information, SFA will determine the best approach to use to bring the school into compliance. This could be either providing technical assistance to improve reporting accuracy or referring the school to a Case Management Team. In addition, as previously stated, we will proactively remind schools that have made disbursements to students

selected for verification that they are required to complete the verification process using COD in 2002-03. COD reports on verification activity will continue to inform the Case Teams of institutional compliance.

Recommendation 4: Modify EDEExpress software to prevent schools from receiving Pell Grant funds without reporting the correct verification results.

Response: We agree with this recommendation. EDEExpress is a PC-based software product provided to schools to process Pell Grant payments by reporting to the Department the amount of Pell Grant paid to a student by the school. We will work to ensure it supports verification properly, taking into consideration changes to verification codes, processing systems and regulatory exceptions.

Other Matters: Implement an income data match with IRS.

Response: We agree that having an income match with the IRS would be beneficial and we are working toward implementing such a match. However, to do this, as we stated in our response to Recommendation #2, there are legal hurdles that we must overcome and we are currently awaiting the outcome of our efforts with Treasury and with Congress.

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